Nos. 75-1870 and 75-1872

In the Supreme Court of the United States

OCTOBER TERM, 1976

E.I. DU PONT DE NEMOURS AND COMPANY AND CHRISTIANA SECURITIES COMPANY, PETITIONERS

v.

RICHARD J. COLLINS, JR., AND LEWIS C. MURTAUGH

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

RICHARD J. COLLINS, JR., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

REPLY BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

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Respondents mistakenly assume that the fairness of a transaction within the meaning of Section 17(b) of the Investment Company Act must be equated with the price that would result when strangers engage in arm's length bargaining. It may well be that, as a general proposition, arm's length bargaining will result in a fair price. But, like most generalizations, that proposition is subject to exceptions.

For example, if one of two strangers enjoys a strategic bargaining advantage because he is the only likely buyer or seller, he may be able to extract a price in unregulated arm's length bargaining that is grossly unfair. We are not concerned here, however, with unregulated transactions between strangers, but with a merger between an investment company and its affiliate that is prohibited by Section 17 unless the Securities and Exchange Commission finds that it is reasonable, fair, and does not involve overreaching by any party involved. 15 U.S.C. 80a-17(a) and (b)(1). The statutory purpose would be undermined if the Commission were required to measure reasonableness, fairness and absence of overreaching in terms of what one strategically positioned stranger could exact from another. Yet, the substance of respondents' argument is that the Commission should not have permitted the merger of Christiana into Du Pont because Du Pont enjoys a strategic bargaining advantage which might have enabled it to obtain Christiana's assets for substantially less in an unregulated arm's length transaction. Respondent's argument would give recognition to the very overreaching which the statute is designed to prevent.

As we have shown in our main brief (pp. 33-39), the Commission's settled position under Section 17(b) with respect to mergers of investment companies with affiliates gives no weight to the strategic bargaining position of any person involved in the transaction. Instead, the Commission has consistently approved investment company mergers in which the terms primarily reflected the net value of the investment company's securities portfolio—the company's net asset value.[1] The Commission has thus viewed the fairness standard as requiring that the investment company be

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[1] In using the term "investment company" in this context, we are not including companies which, while required to be registered under the Investment Company Act because their primary business is that of

valued on the basis of the value of the assets which the company contributes to the surviving entity.

The Commission's decision in the present case is consistent with its previous holdings. It reflects its considered determination that, if Du Pont were permitted to use its strategic bargaining position to extract from Christiana's shareholders a substantial portion of the benefits flowing to them from the proposed Du Pont-Christiana merger, that result would be unfair to Christiana and its shareholders. The Commission recognized that, in bargaining between unrelated parties, Du Pont might have been able to exact "a handsome price for permitting consummation of the transaction in a form that relieves the Christiana stockholders of their tax problems" (Pet. App. 24a). But it found

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investing in securities, also have an operating business and are thus of a hybrid nature. In the valuation of such a hybrid company, it may be appropriate not to rely primarily on net asset value but to give substantial weight to various factors appropriate to the valuation of operating companies. See our main brief at pp. 22-24, 38.

Respondent Murtaugh's failure to appreciate the difference between a conventional investment company and a hybrid company leads him, at p. 24 of his brief, to cite *Atlas Corporation*, 37 S.E.C. 72, as showing that the Commission has not consistently used net asset value in valuing investment companies. In that case the Commission was considering the merger into the Atlas Corporation of certain of its affiliates, including the Wasatch Corporation. Both Atlas and Wasatch were registered investment companies, but a substantial part of their holdings were in "special situation" investments (*id.* at 74-75, 81), where they were rehabilitating operating businesses through controlling interests. See Kerr, *The Inadvertent Investment Company: Section 3(a) (3) of the Investment Company Act*, 12 Stan. L. Rev. 29, 47-48 (1959). The Commission refused to value Wasatch on the basis of prices paid for its stock during a brief premerger period of trading on the American Stock Exchange. It found "that the prices at which [Wasatch's] shares have been traded are wholly unrealistic on any reasonable basis of valuation" (*id.* at 88). It then set forth the language quoted in the Murtaugh brief (p. 24) that "market prices are an important factor to be considered in approving the fairness of transactions under the standards of Section 17 of the Act"; but in context this related solely to a hybrid investment company and, in any event, was *dictum*.

that such an approach would "work positive injustice" by stripping Christiana shareholders of some of the "intrinsic value" of their holdings (Pet. App. 33a).[2] On the other hand, the Commission found there would be no detriment to the stockholders of Du Pont.[3]

This transaction therefore presented no reason for a departure from the Commission's traditional view of fairness. Rather, the Commission's conclusion was a reasonable exercise of its responsibility under Section 17(b) to assure that the transaction was fair to all concerned.

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[2]In urging that fairness requires that Du Pont obtain a substantial share of the benefits which would be derived from the merger by the shareholders of Christiana, respondent Murtaugh cites (Br. 32) Brudney and Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 Harv. L. Rev. 297 (1974). That article, however, deals with a different situation from that involved here. The article discusses the situation in which "the merger is perceived as producing gains *for the combined enterprise*" (*id.* at 305; emphasis added), *i.e.*, where "*the value of the merged entity* is seen to exceed the sum of the premerger values of [the two companies] taken separately" (*id.* at 308; emphasis added), and considers whether there should be a sharing of the "resulting increment" (*id.* at 309). The merger involved here results in no change in the surviving company, Du Pont: it does not affect its operations, its assets or liabilities, or anything else that would increase Du Pont's value. Accordingly, there is no "resulting increment" from the merger in the sense that the term was used in the Brudney and Chirelstein article.

[3]The Collins brief (p. 10), in attempting to show that "the proposed merger inflicts detriments on the non-Christiana holders" of Du Pont stock, inconsistently states (p. 11) that where there is a holding company such as Christiana "taking the control away from the public stockholders," the latter have suffered detriment in that they are for practical purposes deprived of "their legal right to vote" (*ibid.*). Accordingly, contrary to the conclusion in the Collins brief, the proposed merger, by eliminating Christiana, is beneficial to the "public stockholders" of Du Pont to the extent they are thus enfranchised. *Cf.* Section 11(b)(2) of the Public Utility Act of 1935, 15 U.S.C. 79k(b)(2), and Pet. App. 20a-21a n. 42.

CONCLUSION

For the reasons stated in our main brief and this reply brief, the judgment of the court of appeals should be reversed and the case remanded to that court with instructions to affirm the Commission's order.

Respectfully submitted.

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